



Arizona Utility
Investors Association

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BEFORE THE ARIZONA CORPORATION COMMISSION

ORIGINAL
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ARIZONA CORPORATION COMMISSION
DOCKETED
AUG 14 4 03 PM '00
AUG 14 2000

CARL J. KUNASEK
CHAIRMAN
JAMES M. IRVIN
COMMISSIONER
WILLIAM A. MUNDELL
COMMISSIONER

DOCUMENT DOCKETED BY
[Signature]

IN THE MATTER OF THE JOINT APPLICATION OF) DOCKET NOS.
CITIZENS UTILITIES COMPANY, AGUA FRIA WATER) W-01032A-00-0192
DIVISION OF CITIZENS UTILITIES COMPANY,) W-01032B-00-0192
MOHAVE WATER DIVISION OF CITIZENS UTILITIES) W-01032C-00-0192
COMPANY, SUN CITY WATER COMPANY, SUN CITY) W-01656B-00-0192
CITY SEWER COMPANY, SUN CITY WEST UTILITIES) S-02276A-00-0192
COMPANY, CITIZENS WATER SERVICE COMPANY OF) WS-02334A-00-0192
ARIZONA, CITIZENS WATER RESOURCES COMPANY) WS-03454A-00-0192
OF ARIZONA, HAVASU WATER COMPANY AND) WS-03455A-00-0192
TUBAC VALLEY WATER COMPANY FOR APPROVAL) W-02013A-00-0192
OF THE TRANSFER OF THEIR WATER AND WASTE-) W-01595A-00-0192
WATER UTILITY ASSETS AND THE TRANSFER OF) W-01303A-00-0192
THEIR CERTIFICATES OF CONVENIENCE AND)
NECESSITY TO ARIZONA-AMERICAN WATER)
COMPANY AND FOR CERTAIN RELATED APPROVALS.)

NOTICE OF FILING

The Arizona Utility Investors Association hereby
provides notice of filing Direct Testimony as required by the
Commission's procedural order in the above-captioned matter.

DATED THIS 14TH DAY OF AUGUST, 2000.

WALTER W. MEEK, PRESIDENT

CERTIFICATE OF SERVICE

Original and ten (10) copies of the
referenced Testimony were filed this
14th day of August, 2000, with:

Docket Control
Arizona Corporation Commission
1200 W. Washington Street
Phoenix, AZ 85007

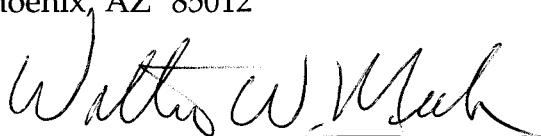
Copies of the referenced Testimony
were hand-delivered this 14th day
of August 2000, to:

Lyn Farmer, Legal Division
Deborah R. Scott, Utilities Division
Jerry L. Rudibaugh, Hearing Division
Arizona Corporation Commission
1200 W. Washington
Phoenix, AZ 85007

Copies of the referenced Testimony
were mailed this 14th day of August,
2000, to the following parties of record:

Ray Jones
General Manager
Sun City Water Company
P.O. Box 1687
Sun City, AZ 85372

Norman D. James
Fennemore Craig
3003 N. Central Ave., Suite 2600
Phoenix, AZ 85012

A handwritten signature in cursive script, reading "Walter W. Meek", written over a horizontal line.

Walter W. Meek

Craig Marks
General Counsel
Citizens Utilities Company
2901 N. Central Ave., Suite 1660
Phoenix, AZ 85012

Scott Wakefield, Chief Counsel
RUCO
2828 N. Central Ave., Ste. 1200
Phoenix, AZ 85004

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DIRECT TESTIMONY

OF

WALTER W. MEEK

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Walter W. Meek. My business address is 2100 North Central Avenue, Suite 210, Phoenix, Arizona 85004.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am the president of the Arizona Utility Investors Association ("AUIA" or "Association"), a non-profit organization formed to represent the interests of shareholders and bondholders who are invested in utility companies based in or doing business in the state of Arizona.

Q. ARE SOME AUIA MEMBERS SHAREHOLDERS OF THE JOINT APPLICANTS IN THIS PROCEEDING?

A. Yes. AUIA has approximately 6,500 individual members, including common shareholders of Citizens Communications Company (formerly Citizens Utilities), the parent company of the certificate holders in this application.

Q. WHAT IS YOUR BACKGROUND IN REPRESENTING SHAREHOLDER CONCERNS AND INTERESTS?

A. I have been president of AUIA for more than five years. Prior to that, my consulting firm managed the affairs of the Pinnacle West Shareholders Association for 13 years. During these periods we have represented shareholders in numerous rate cases and other regulatory matters and have published many position papers, newsletters and other documents in support of shareholder interests.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. I am here to represent the views of the equity owners of Citizens Communications in the sale of Citizens' water and wastewater business to Arizona-American Water Company.

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2 Q. IN YOUR OPINION, DOES THIS TRANSACTION SERVE THE BEST
3 INTERESTS OF CITIZENS' SHAREHOLDERS?

4 A. Yes.
5

6 Q. WHY IS THAT?

7 A. Within the past year, Citizens has adopted a business strategy of focusing
8 exclusively on telecommunications while divesting its traditional
9 electric, water and gas businesses. It is expanding its telephone business
10 substantially by acquiring local exchanges from other carriers such as
11 Global Crossing, GTE and Qwest Communications.
12

13 Q. WHAT IS THE REASON FOR THIS CHANGE IN STRATEGY?

14 A. The financial markets view telecommunications as a business that is
15 more dynamic than traditional utility business, with higher risks and
16 higher rewards. In the past, Citizens had difficulty in getting Wall Street
17 analysts to accept the growth and earnings potential of its mixed business
18 portfolio.
19

20 Q. ARE THERE OTHER REASONS FOR THIS CHANGE?

21 A. Clearly, Citizens believes it can achieve management and operational
22 efficiencies in concentrating on a core business rather than operating
23 dissimilar businesses in several regulatory jurisdictions.
24

25 Q. FROM THE SHAREHOLDER'S PERSPECTIVE, IS THIS STRATEGY
26 WORKING?

27 A. So far, the financial markets have given their approval. The value of
28 Citizens' common stock has doubled since the company embarked on
29 this strategy about a year ago.
30

31 Q. IS THIS TRANSACTION CRITICAL TO THE OVERALL STRATEGY?

32
33 A. All of the proposed sales of utility properties are critical elements in the
34 strategy. Citizens is in the process of acquiring about 2 million access
35 lines from other telephone providers. Income from the sale of utility
36 properties is the underlying source of funds to pay for these acquisitions.

1
2 Q. WHERE DOES THIS SALE FIT IN?

3 A. American Water Works and its subsidiaries (American) have agreed to
4 buy all of Citizens' water and waste water assets in six states for a total
5 price of \$835 million. The Arizona purchase accounts for \$231.3 million
6 of that total, or 27.7%. In addition, the buyer assumes \$10.6 million of
7 debt in the form of outstanding industrial development revenue bonds.
8

9 Q. SHOULD THE COMMISSION FIND THAT THIS SALE IS IN THE
10 PUBLIC INTEREST?

11 A. Yes.
12

13 Q. WHAT ARE YOUR REASONS FOR REACHING THAT CONCLUSION?

14 A There are probably a number of reasons, but I will discuss four.

15 *First*, American is well qualified to take over Citizens' business in
16 Arizona. It is the largest investor-owned water service company based
17 in the United States with 10 million customers in 23 states.

18 *Second*, American is on solid financial footing, with a strong balance
19 sheet and \$1.3 billion in operating revenues in the past year. The
20 company asserts that this transaction will not impair its financial status,
21 its ability to obtain capital on reasonable terms or its ability to serve
22 Citizens' customers.

23 *Third*, while Citizens has operated its water business in exemplary
24 fashion, the Commission should consider it a positive opportunity to
25 locate this business within a corporate structure that is focused almost
26 exclusively on water service.

27 *Fourth*, the successful completion of this transaction will help Citizens
28 to concentrate on its telephone business which is expanding in Arizona
29 and which remains under Commission jurisdiction.
30

31 Q. IS AMERICAN WATER WORKS PAYING MORE THAN BOOK
32 VALUE FOR CITIZENS' ASSETS?

33 A. Of course. American is paying for the *market value* of Citizens' assets,
34 including the ongoing value of Citizens' business. Consequently, the
35 gross plant balance of Citizens' Arizona assets is a little over \$167
36 million, but the pro-rated purchase price is \$231.3 million.

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2 Q. WHAT DO YOU MEAN BY PRO-RATED?

3 A. The purchase price of the Arizona assets is 27.7% of the price American
4 is paying for all of Citizens' water business in six states. That percentage
5 is the same as the ratio of Citizens' book value in Arizona to the book
6 value of everything American is buying from Citizens.
7

8 Q. SHOULD THE COMMISSION BE CONCERNED ABOUT THE
9 DIFFERENCE BETWEEN BOOK VALUE AND PURCHASE PRICE?

10 A. This is an arms-length transaction between a willing seller and a willing
11 buyer. The presumption must be that the price is reasonable. However,
12 any consideration of the impact of the sale price is premature. American
13 has proposed that the ratemaking treatment of the difference be
14 addressed in a general rate case at a future date and that is appropriate.
15

16 Q. ARE YOU CONCERNED ABOUT CONDITIONS THAT MAY BE
17 ATTACHED TO THE COMMISSION'S APPROVAL OF THE SALE?

18 A. I will preface my response by saying that AUIA is at a procedural
19 disadvantage in that we must file testimony without knowing what
20 conditions may be proposed by other parties, particularly Commission
21 staff (Staff) and the Residential Utility Consumers Office (RUCO).
22

23 Q. THAT BEING THE CASE, DO YOU HAVE SOME CONCERNS?

24 A. Within the past 18 months, several applications for mergers and/or
25 acquisitions have been filed with this Commission for its approval. In
26 earlier cases, the Staff and RUCO have argued that shareholders of the
27 selling company should share the so-called gain between book value and
28 the sale price with ratepayers.
29

30 Q. WHAT IS YOUR OBJECTION TO GAIN SHARING?

31 A. There is no legal or economic justification for gain sharing. It
32 unlawfully impedes a transaction by altering its negotiated value. It is
33 simply regulatory blackmail based on false assumptions.
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3 Q. WHAT ARE THESE FALSE ASSUMPTIONS?

4 A. First, the idea that ratepayers have paid for a portion of a utility's plant
5 and have acquired an ownership interest in it. Ratepayers have paid
6 only for the use of the plant and a reasonable rate of return on the
7 shareholders' investment.
8

9 Q. RATEPAYERS PAY FOR DEPRECIATION, DON'T THEY?

10 A. Yes, but depreciation is an expense item in rates and does not contribute
11 anything toward ownership. If ratepayers had an ownership claim on a
12 utility's assets, they would also have to share in any losses the utility
13 experienced in disposing of those assets.
14

15 Q. WHAT IS THE SECOND FALSE ASSUMPTION?

16 A. That the gain is calculated by subtracting book value from the sale price.
17 Book value is an artificial number produced by applying depreciation
18 rates and has nothing to do with market value. Furthermore, Citizens is
19 selling its ongoing water business, including its future profits and
20 growth potential, which is much more valuable than its hard assets.
21

22 Q. DOES AUIA OPPOSE CONDITIONS THAT WOULD REQUIRE
23 CITIZENS TO SHARE THE GAIN ON THE SALE WITH RATEPAYERS?

24 A. Yes. Gain sharing is simply a method of confiscating shareholder equity.
25

26 Q. WHAT IS AUIA'S RECOMMENDATION TO THE COMMISSION?

27 A. To find that the transfer of assets from Citizens Communications to
28 Arizona-American Water Company is in the public interest and to
29 approve the sale without conditions that would alter the values that
30 were freely negotiated by the applicants.
31

32 Q. DOES THAT CONCLUDE YOUR TESTIMONY?

33 A. Yes, it does.
34